No. 12,136

IN THE

United States Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

JOE SHOONG,
Respondent.

and

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

ROSE SHOONG,
Respondent.

On Petition for Review of the Decision of the Tax Court of the United States.

CONSOLIDATED BRIEF FOR RESPONDENTS.

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A. OPINION BELOW.

The Memorandum Findings of Fact and Opinion of the Tax Court, including the decisions, (R. 31, et seq.) are reported at 7 TCM-367 (CCH).

B. JURISDICTION.

The consolidated appeals concern alleged deficiencies asserted by the Commisioner of Internal Revenue in respect to the respondents' personal income taxes for the year 1944. The two cases affecting each of the respondents have been consolidated for briefing, hearing, argument and decision. (R. 52.) The consolidated cases are brought to this Court by a petition filed October 25, 1948, (R. 39) by the said Commissioner to review the aforesaid decision of the Tax Court entered August 9, 1948, which redetermined a deficiency as to the respondent, Joe Shoong, in the amount of $136.63 (R. 37), and as to respondent, Rose Shoong, in the amount of $557.44 (R. 38).

The amount in controversy in the case of Joe Shoong is $58,441.99 (R. 8), and $61,841.00 in the case of Rose Shoong (R. 16, 18), representing those portions of the alleged deficiencies determined by the Commissioner which were disallowed by the Tax Court.

Jurisdiction is conferred on the above entitled Court by Section 1141 (a) of the Internal Revenue Code as amended by Section 36 of the Act of June 25, 1948.

C. QUESTION PRESENTED.

The question presented in these consolidated appeals is whether the Tax Court properly determined that the respondents may take as a deduction in computing their 1944 net taxable income the amortization of premiums paid by them in the purchase in 1944 of American Tele-

phone and Telegraph Company fifteen year, three per cent, convertible debenture bonds dated September 1, 1941, and due September 1, 1956.

D. STATUTES AND REGULATIONS INVOLVED.

(a) INTERNAL REVENUE CODE.

Sec. 23. Deductions from Gross Income.—In computing net income there shall be allowed as deductions:

* * * * * * *

(v) Bond Premium Deduction.—In the case of a bondholder, the deduction for amortizable bond premium provided in section 125.

Sec. 125. Amortizable Bond Premium

(a) **General rule.**—In the case of any bond, as defined in subsection (d), the following rules shall apply to the amortizable bond premium (determined under subsection (b)) on the bond for any taxable year beginning after December 31, 1941:

(1) **Interest wholly or partially taxable.**—In the case of a bond (other than a bond the interest on which is excludable from gross income), the amount of the amortizable bond premium for the taxable year shall be allowed as a deduction.

* * * * * * *

(b) **Amortizable bond premium.**—

(1) **Amount of bond premium.**—For the purposes of paragraph (2), the amount of bond premium, in the case of the holder of any bond, shall be determined with reference to the amount of the basis (for determining loss on sale or exchange) of such bond, and with reference to the amount payable

on maturity or on earlier call date, with adjustments proper to reflect unamortized bond premium with respect to the bond, for the period prior to the date as of which subsection (a) becomes applicable with respect to the taxpayer with respect to such bond.

(2) **Amount amortizable.**—The amortizable bond premium of the taxable year shall be the amount of the bond premium attributable to such year.

(3) **Method of determination.**—The determinations required under paragraphs (1) and (2) shall be made—

(A) in accordance with the method of amortizing bond premium regularly employed by the holder of the bond, if such method is reasonable;

(B) in all other cases, in accordance with regulations prescribing reasonable method of amortizing bond premium, prescribed by the Commissioner with the approval of the Secretary.

(c) **Election on taxable and partially taxable bonds.**—

(1) **Eligibility to elect and bonds with respect to which election permitted.**—This section shall apply with respect to the following classes of taxpayers with respect to the following class of bonds only if the taxpayer has elected to have this section apply.

(A) Partially Tax-Exempt.—In the case of a taxpayer other than a corporation, bonds with respect to the interest on which the credit provided in section 25(a) (1) or (2) is allowable; and

(B) Wholly Taxable.—In the case of any taxpayer, bonds the interest on which is not

excludable from gross income, but with respect to which the credit provided in section 25(a) (1) or (2), or section 26(a), as the case may be, is not allowable.

(2) **Manner and effect of election.**—The election authorized under this subsection shall be made in accordance with such regulations as the Commissioner with the approval of the Secretary shall prescribe. If such election is made with respect to any bond (described in paragraph (1)) of the the taxpayer, it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies and to all such bonds thereafter acquired by him and shall be binding for all subsequent taxable years with respect to all such bonds of the taxpayer, unless, upon application by the taxpayer, the Commissioner permits him, subject to such conditions as the Commissioner deems necessary, to revoke such election.
* * *

(d) **Definition of bond.**—As used in this section, the term "bond" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof), with interest coupons or in registered form, but does not include any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(b) REGULATIONS 111.

Sec. 29.125-1. In General.—(a) **Application.**—Section 125 makes provision for the amortization of bond premium by the owners of the bonds.

* * * * * * *

It is optional at the election of the taxpayer, with respect to—

(1) fully taxable bonds (the interest on which is subject to normal tax and surtax), whether the owner is a corporation, individual or other taxpayer; and

(2) partially tax-exempt bonds owned by taxpayers other than corporations.

Sec. 29.125-2. Bond Premium and Amortizable Bond Premium.—Bond premium on any bond to which section 125 applies is the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date. (For determination of applicable call date see section 29.125-5.) * * *

Sec. 29.125-3. Methods of Amortization.—The determinations of the bond premium and amortizable bond premium of any bond to which section 125 applies shall be made in accordance with:

(a) the method of amortization regularly employed by the taxpayer, if such method is reasonable; or

(b) the method of amortization prescribed by this section.

A method of amortization will be deemed "regularly employed" by a taxpayer if the method was consistently followed in taxable years beginning prior to

January 1, 1942, or if for taxable years beginning on or after such date the taxpayer (including a taxpayer who followed a different method in taxable years beginning prior to January 1, 1942) initiates in the first taxable year for which the deduction is taken a reasonable method of amortization and consistently follows such method thereafter. A taxpayer who regularly employs a method of amortization may be one, for example, who is subject to the jurisdiction of a State or Federal regulatory agency and who, for the purposes of such agency, amortizes the bond premium on his bonds in accordance with a method prescribed or approved by such agency. However, it is not necessary that the taxpayer be subject to the jurisdiction of such an agency or that the method be prescribed or approved by such agency. It is sufficient if the taxpayer regularly employs a method of amortization and if such method is reasonable.

The method of amortization prescribed by this section is as follows:

(1) The bond premium on any bond to which section 125 applies shall be determined in accordance with section 29.125-2 and shall be computed as of the end of the taxable year (or as of the date of disposition or redemption of the bond, if it was disposed of or redeemed in the taxable year) but without regard to the amortizable bond premium for the taxable year; and

(2) The amortizable bond premium on such bond for the taxable year shall be an amount which bears the same ratio to the bond premium on the bond as the number of months in the taxable year during which the bond was owned by the taxpayer bears to the number of months from the beginning of the taxable year (or, if the bond was acquired

in the taxable year, from the date of acquisition) to the date of maturity or earlier call date. For the purposes of this section a fractional part of a month shall be disregarded unless it amounts to more than half a month in which case it shall be considered as a month.

Sec. 29.125-5. Callable and Convertible Bonds.—The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of section 125. For the purposes of such section, in the case of a callable bond the earlier call date will be considered as the maturity date and the amount due on such date will be considered as the amount payable on maturity, unless the taxpayer regularly employs a different method of amortization which is reasonable. Hence, the bond premium on such a bond is required to be spread over the period from the date as of which the basis for loss of the bond is established down to the earlier call date, rather than the maturity date. The earlier call date may be the earliest call date specified in the bond as a day certain, the earliest interest payment date if the bond is callable at such date, the earliest date at which the bond is callable at par, or such other call date, prior to maturity, specified in the bond as may be selected by the taxpayer. A taxpayer who deducts amortizable bond premium with reference to a particular call date may not thereafter use a different call date in the calculation of amortization deductions with respect to such premium. A convertible bond is within the scope of section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof.

E. STATEMENT OF THE CASE.

The facts are for the most part set forth in a stipulation received in evidence as Exhibit A-1. (R. 20.) The following statement embraces all the facts that respondents deem to be pertinent.

1. Respondents are husband and wife and reside in Oakland, California. Joe Shoong has an office at 929 Market Street, San Francisco, California (Ex. A-1, Par. 1). (R. 20.)

2. Respondents filed separate returns for the calendar year 1944 with the Collector of Internal Revenue for the First District of California on a community property basis (Ex. A-1, Par. 2). (R. 20-21.)

3. Joe Shoong on June 21, 1944, purchased bonds of the issue described, as follows (Ex. A-1, Par. 3) (R. 21.):

Principal of Bonds	$500,000.00
Cost	$600,625.00
Commission	1,250.00
Accrued interest	4,666.66
Total	$606,541.66

4. Joe Shoong in his income tax return for 1944 reported adjusted gross income of $104,304.58 and deductions of $97,533.76, which latter amount included a claim of $81,879.94 amortization of bond premium on American Telephone and Telegraph Company debenture bonds and reported a net income of $6,770.82 (Ex. A-1, Par. 4). (R. 21.)

5. Rose Shoong purchased on June 26 and June 27, 1944, bonds of the same issue, as follows (Ex. A-1, Par. 5) (R. 22.):

	June 26, 1944	June 27, 1944	Total
Principal	$165,000.00	$335,000.00	$500,000.00
Cost	$198,725.00	$405,623.75	$604,348.75
Commission	412.50	837.50	1,250.00
Accrued interest	1,608.75	3,294.17	4,902.92
Total	$200,746.25	$409,755.42	$610,501.67

6. Rose Shoong in her income tax return for 1944 reported adjusted gross income of $100,927.43 and deductions of $96,235.84, which latter figure included a claim of $85,607.29 as amortization of bond premium on American Telephone and Telegraph Company bonds and reported a net income of $4,691.59 (Ex. A-1, Par. 6). (R. 22.)

7. (a) The bonds were issued under an indenture between American Telephone and Telegraph Company and City Bank and Farmers Trust Company as Trustee, dated September 1, 1941, a true and correct copy of which is in evidence herein as Exhibit H. (R. 23.)

(b) The bonds were convertible into capital stock of the issuing company at any time after January 1, 1942, and before January 1, 1954, at the conversion price of $140.00 per share, subject to certain adjustments (Ex. H, Sec. 4.04) not pertinent here. (R. 21.)

The terms of conversion of the bonds were stated as follows on the bond (Ex. H) (R. 54, Ex. H.):

TERMS OF CONVERSION OF DEBENTURE BONDS INTO CAPITAL STOCK

At any time after January 1, 1942 but not later than December 31, 1954, unless previously called for redemption, the debenture bonds will be convertible into capital stock of the company. The conversion price will be $140 per share, payable by surrender of $100 principal amount of debenture bonds and payment to the company of $40 in cash for each share of capital stock to be issued upon conversion. The conversion price, the number of shares issuable upon conversion and the amount of cash per share payable upon conversion will be subject to adjustment as provided in the indenture.

Surrender of debenture bonds (with unmatured coupons attached) for conversion and payment of cash required upon the conversion is to be made at the office of the treasurer of the company, 195 Broadway, New York, N. Y.

DEBENTURE BONDS MAILED SHOULD BE SENT BY REGISTERED MAIL

(c) The Company had the option to redeem all or from time to time any part of the redemption bonds on or after September 1, 1942, at the following redemption prices (expressed in percentage of the principal amount), together with accrued interest to the date of redemption (Ex. H, pages 28-29) (R. 54, Ex. H.):

To and including August 31, 1944, 107%
Thereafter to and including August 31, 1948, 104%
Thereafter to and including August 31, 1953, 102%
Thereafter, 100%

(d) Notice of exercise of the right to redeem the bonds was required to be published at least four times, the first publication to be not less than 30 days and not more than 90 days before the date fixed for redemption (Ex. H, page 29). (R. 54, Ex H.)

(e) The entire issue of the bonds was called for redemption under the provisions of the bond indenture for payment on September 1, 1947, at 104%, plus interest (Ex. A-1, Par. 10). (R. 23.)

8. The bonds purchased by Joe Shoong and Rose Shoong were not part of their stock in trade, or includible in any inventory of the respondents at the close of the taxable year, or held by them primarily for sale to customers in the ordinary course of their trade or business. They did not, during the calendar year 1944, sell any of the bonds purchased by them, as aforesaid, nor did they exercise their privilege of converting said bonds into capital stock of the company (Ex. A-1, Par. 17). (R. 28-29.)

9. In the deficiency notice the Commissioner determined for the year 1944 with respect to Joe Shoong, as follows (Ex. A-1, Par. 19) (R. 9.):

> "(d) You claimed a deduction of $81,879.94 for amortization of bond premium as follows:
>
> | | |
> |---|---|
> | $500,000.00 face value American Telephone and Telegraph 3% Convertible Bonds of 1956 | |
> | Cost | $601,879.94 |
> | Call price at $104.00 | 520,000.00 |
> | Amortization | $81,879.94 |

The deduction is disallowed since it is held that the amount does not represent amortizable bond premium. It is held that the consideration represents the value of the right to convert the bonds into capital stock of the company." (R. 9, 29.)

10. In the deficiency notice the Commissioner determined for the year 1944 with respect to Rose Shoong, as follows (Ex. A-1, Par. 20):

"(e) You claim a deduction of $85,607.29 for amortization of bond premium as follows:

$500,000.00 face value American Telephone and Telegraph 3% Convertible Bonds of 1956	
Cost	$605,607.29
Call price at $104.00	520,000.00
Amortization	$85,607.29

The deduction is disallowed since it is held that the amount does not represent amortizable bond premium. It is held that the consideration represents the value of the right to convert the bonds into capital stock of the company." (R. 17-18, 30.)

While, in our view of the case the foregoing are all the facts that are pertinent to the issue, petitioner deems pertinent the further fact that respondents at the time they purchased these bonds intended to amortize the premium paid and to sell the bonds six months thereafter or later, subject to the tax on long term capital gain, and that they sold the bonds in January 1945. We shall endeavor to show in the argument to follow that these circumstances have no bearing upon the question whether

the bond premium is deductible within the meaning and intent of the Code provision.

The dates of the sale of the bonds and proceeds realized are set forth in paragraphs 7 and 8 of the Stipulation of Facts, Exhibit A-1 (R. 21-23).

F. DECISION BY TAX COURT.

An excerpt from the decision by the Tax Court in these cases is set out in Appendix A, *post*.

G. DECISION BY TAX COURT IN RE KORELL, 10 T. C. 1001.

Since the Tax Court in its decision in these cases followed its earlier decision in the *Korell* case (R. 36), we find it desirable to refer to and quote from the opinion in that case. Excerpts from that opinion are set out in Appendix B, *post*.

H. SUMMARY OF ARGUMENT.

1. Under the provisions of the Internal Revenue Code, respondents are entitled to amortize or deduct premiums paid by them upon the bonds purchased.

2. The right to amortize or deduct the aforementioned premiums rests not only upon the letter of the Code provisions, but also upon the obvious intent of the basic statute.

3. The statutory right is recognized in the Regulations issued by the Commissioner in pursuance of the Code Section.

4. Section 125 of the Internal Revenue Code declares unambiguously the precise rules for the determination of the existence of bond premium and the amount thereof.

5. The amount of the bond premium amortized by each of the respondents respectively shows substantial if not exact compliance with the terms of Section 125 of the Code, and is therefore fully deductible under Section 23 (v) thereof.

I. ARGUMENT.

1. UNDER THE PROVISIONS OF THE INTERNAL REVENUE CODE, RESPONDENTS ARE ENTITLED TO AMORTIZE OR DEDUCT PREMIUMS PAID BY THEM UPON THE BONDS PURCHASED.

The pertinent provisions of the Code have been set out in full under Subdivision D, supra. It should be sufficient to direct attention to the particular provisions that are determinative of the issues in this particular case.

The term "bond" as used in the Code is defined as

> "* * * any bond, debenture, note, or certificate or other evidence of indebtedness," etc.

There is expressly excluded from the definition of the term "bond"

> "* * * any such obligation which constitutes stock in trade of the taxpayer or any such obligation of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of

the taxable year, or any such obligation held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

It was stipulated in the Tax Court in the light of the foregoing provision of Subdivision (d) of Section 125 that:

"17. The bonds purchased by petitioners, Joe Shoong and Rose Shoong, were not part of the stock in trade of the petitioners, or includible in any inventory of the petitioners at the close of the taxable years, or held by the petitioners primarily for sale to customers in the ordinary course of their trade or business. Petitioners did not, during the calendar year 1944, sell any of the bonds purchased by them, as aforesaid, nor did they exercise their privilege of converting said bonds into capital stock of the company." (R. 28, 29.)

The phrase, "any bond," etc. appearing in the first portion of Subdivision (d), appears to be all-inclusive and therefore includes callable and convertible bonds. The exclusion clause in the latter par of Subdivision (d) contains no express reference to callable or convertible bonds as such, and since particular expressions are limited in their qualification of general expressions, we urge that the general definition of the term "bond" in the first part of Subdivision (d) is expressly limited by the qualification appearing in the latter portion of said subdivision.

The duty rested upon Congress to determine the nature and extent of the qualification or exception to the term "bond", and since Congress did not include in the quali-

fication or exception "callable or convertible bonds", that fact raises a conclusive presumption that Congress did not intend to make them, and it is not the province of the Court to do so.

Wabash R. R. Co. v. U. S., (8th Cir.) 178 F. 5, 11;
U. S. v. Pan American etc., (9th Cir.) 55 F. (2d) 758, 772.

Since the latter portion of Subdivision (d) is designed to be an exception, the maxim, "*expressio unius est exclusio alterius,*" applies. It is a well settled principle of statutory construction that the expression of one thing excludes others not expressed.

Jones, Collector of Internal Revenue v. Crosswell, (4th Cir.) 60 F. (2d) 827, at 828.

To expand the qualifying exception in the latter part of Subdivision (d) by including callable and convertible bonds would violate the cardinal rule of statutory construction which requires exceptions to be strictly construed.

Midland v. Ickes, (8th Cir.) 125 F. (2d) 618, at 625-6.

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2. THE RIGHT TO AMORTIZE OR DEDUCT THE AFOREMENTIONED PREMIUMS RESTS NOT ONLY UPON THE LETTER OF THE CODE PROVISIONS, BUT ALSO UPON THE OBVIOUS INTENT OF THE BASIC STATUTE.

Both the House and Senate Committee Reports in connection with the Revenue Act of 1942, which added Sections 23 (v) and 125 to the Code, affirmatively set forth that:

> "The fact that a bond is callable or convertible into stock does not of itself prevent the application of this section. In the case of a callable bond, the earliest call date will, for the purposes of this section, be considered as the maturity date. Hence, the total premium is required to be spread over the period from the date as of which the basis of the bond is established down to the earliest call date, rather than down to the maturity date. In the case of a convertible bond, *if the option to convert the bond into stock rests with the owner of the bond, the bond is within the purview of this section.*" (Emphasis added.)
>
> H. Rep. No. 2333, 77th Cong., 2d Sess., p. 80 (1942-2 CB 372, 433-434); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 94 (1942-2 CB 504, 576).

Under Section 125 (b) (1) of the Code, the amount of the bond premium to be amortized is the difference between the cost or basis and

> "* * * the amount payable on maturity or on earlier call date."

As stated supra, in Paragraphs 7 (c) and 7 (d) of the Statement of the Case, the bonds were subject to call at any time on or after September 1, 1942, and to and including August 31, 1953, on thirty days' notice of desire to exercise the right to redeem. Accordingly, the earliest call date with respect to any bonds purchased by the respondents in 1944 was thirty days from the purchase, and the bond premium was therefore to be amortized over the thirty day period.

In the opinion of the Tax Court rendered in the *Korell* case, the italicized portion of the language of the Committee Reports set forth supra, is

> "* * * unequivocal and precisely includes the bonds in controversy."

There can appear to be no doubt that the statute as finally enacted by the Congress incorporates the legislative intent as reflected by the House and Senate Committee Reports, all as expressed in the portion above quoted, by providing without equivocation that the rules prescribed by Section 125 apply not only to all bonds coming within the definition of the term as outlined in Subdivision (d), but as well apply in the case of "any bond" as outlined in Subdivision (a), and likewise apply "in the case of the holder of any bond" as outlined in Subdivision (b) (1).

In *Broadcasting etc. Inc. v. Federal Communications Commission* (Dist. of Col.), 171 F. (2d) 1007, 1010, the Court reaffirmed the principle that the most accurate guides for determining legislative intent and purpose

> "* * * are the words themselves which were enacted into law, provided those words are unambiguous and unequivocal"

and when language of a statute meets these tests it becomes

> "* * * not only the privilege but the duty of this court"

to interpret such statute accordingly.

In *Algoma Plywood etc. Co. v. Wisconsin Employment Relations Board,* decided by the Supreme Court of the United States on March 7, 1949, Mr. Justice Frankfurter, speaking for a majority of the Court, declared, in effect, that Courts are not justified in rejecting legislative in-

terpretation of a statute placed upon it at the time of its enactment, nor to adopt a construction in disregard of legislative history.

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3. THE STATUTORY RIGHT IS RECOGNIZED IN THE REGULATIONS ISSUED BY THE COMMISSIONER IN PURSUANCE OF THE CODE SECTION.

The Regulations issued in pursuance of the directions contained in Section 125 recognize the right to amortize bond premiums as was here done by the respective respondents. Section 29.125-5 of Regulations 111 has a heading reading as follows: "Callable and Convertible Bonds." The introductory sentence thereto declares:

> "The fact that a bond is callable or convertible into stock does not, in itself, prevent the application of Section 125."

Later in the same section the following sentence appears:

> "A convertible bond is within the scope of Section 125 if the option to convert on a date certain specified in the bond rests with the holder thereof."

There is no dispute that the bonds were convertible at the option of the holder at any date he chose, commencing with January 2, 1942, and ending with December 31, 1954. (See supra, Statement of the Case, 7 (b).)

It is respectfully submitted that the language of the Regulations 111, Section 29.125-5, are clearly unambiguous, intelligible, and plain. Notwithstanding this fact, the Commissioner seems to take a position completely at variance with the plain significance of the statute and the Regulations.

Of course, the Regulations seek to restrict the application of Section 125 in the case of convertible bonds to bonds conferring the privilege to convert "on a date certain," but this has been characterized by the Tax Court in the *Korell* case as "a gratuitous addition" on the part of the Commissioner

> "* * * not founded upon the statutory language and directly in conflict with its legislative history." (See *post,* Appendix B.)

The Tax Court added that the difficulty with the Commissioner's "entire position" was that he ignored

> "* * * the interpretation which Congress itself placed upon the legislation." (See *post,* Appendix B.)

It is respectfully submitted that in so deciding the *Korell* case, and in adopting the conclusions reached in the *Korell* case for these cases, the Tax Court did not err.

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4. SECTION 125 OF THE INTERNAL REVENUE CODE DECLARES UNAMBIGUOUSLY THE PRECISE RULES FOR THE DETERMINATION OF THE EXISTENCE OF BOND PREMIUM AND THE AMOUNT THEREOF.

In each of the notices of deficiency sent to the respondents by the Commissioner the deductions claimed were disallowed in the following language:

> "The deduction is disallowed since it is held that the amount does not represent amortizable bond premium. *It is held that the consideration represents the value of the right to convert the bonds into capital stock of the company.*" (Emphasis ours.) (R. 9 and 18.)

In essence, the italicized sentence is the petitioner's theme which runs like a thread through the fabric of his opening brief. In other words, the petitioner claims that the respondents should be denied the right to amortize the premiums admittedly paid for the bonds because of the "conversion privilege acquired with the bonds." (Pet. Br. 14.) The answers to such contention have already been supplied in the earlier portions of this brief, and may be recapitulated as follows:

(a) Convertible bonds were not excluded from the definition of "bonds" under the Code. In fact, the Commissioner concedes in his brief that

> "* * * so far as the question here involved is concerned it may be assumed that the debentures of American Telephone and Telegraph Company met this definition of the statute." (Pet. Br. 19.)

(b) Both the Senate and House Committee Reports affirmatively disclose such bonds were intended to be excluded. The Tax Court in the *Korell* case declared that

> "* * * petitioner's application of the provision to his situation and his computation of the deduction are thus squarely justified by the expression of Congressional intent." (See *post,* Appendix B.)

Of course, the Commissioner frankly declares that he cannot agree with the conclusion reached by the Tax Court.

(c) The Regulations promulgated by the Commissioner specifically and clearly state that convertible bonds are within the scope of the Code provision. Upon this point the Commissioner's position seems to be equivocal, for while he admits that

> "* * * a convertible bond is within the scope of Section 125 of the Code if the option to convert on a date certain specified in the bond rests with the holder thereof,"

the Commissioner adds that Section 29.125-5 of the Regulations

> "* * * does not necessarily exclude bonds convertible at any time by the holder," (Pet. Br. 14.)

and his brief further adds that

> "* * * to the extent that the Tax Court's decision purports to hold the Regulations invalid, it in turn is gratuitous." (Pet. Br. 14.)

We assert that the plain and unambiguous definition of "bond premium" as set forth in the Code must prevail even though the Commissioner contends that the amount paid was not

> "* * * true bond premium within the intendment of the statute and Regulations."

The simple language of the statute supplies the most forceful reply to the Commissioner's contention. Subdivision (b) (1) of Section 125 declares that the amount of the bond premium

> "* * * shall be determined with reference to the amount of the basis * * * of such bond and with reference to the amount payable on maturity or on earlier call date."

The word "basis" of course means "cost".

The simplicity of the foregoing language gave birth to equally simple language which the Commissioner placed in his Regulations 111 (Section 29.125-2) as follows:

> "Bond premium on any bond to which Section 125 applies is the excess of the amount of the basis (for determining loss on sale or exchange) of the bond over the amount payable at maturity or, in the case of a callable bond, earlier call date."

What more is needed to clarify that which is already crystal clear, unless it be to put a polish upon the transparent surface of plain language. This function may be performed by a further excerpt from the Reports of the House Ways and Means Committee and the Senate Finance Committee, accompanying the Revenue Act of 1942, which reads:

> "Bond premium, in the case of any bond subject to this section, is the total premium thereon; that is, the excess of the basis of the bond for determining loss over the amount payable at maturity. On the other hand, amortizable bond premium is such part of the total premium on the bond as is attributable to the taxable year."
>
> H. Rep. No. 2333, 77th Cong., 2d Sess., p. 79 (1942-2 CB 372, 432); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 93 (1942-2 CB 504, 574-575).

The petitioner undertakes to sweep all this aside by reiterating either that the statute does not authorize the deduction of something which is not "true bond premium," or by stating that

> "* * * there is nothing in the statute or its legislative history to justify any such interpretation," (Pet. Br. 17.)

or that the position taken by the taxpayer and approved by the Tax Court is not "within the meaning of the statute".

It should require little citation of authority to support the well-known principle that the intention of Congress is to be sought for primarily in the language used, and where this expresses an intention reasonably intelligible and plain, it must be accepted without modification by resort to construction or conjecture.

Thompson v. U. S., 246 U.S. 547, 62 L. Ed. 876;

Caminetti v. U. S., 242 U.S. 470, 61 L. Ed. 442, 453;

In re Borchert (Cal.), 47 F. Supp. 387, 390.

The Courts are not at liberty to construe language so plain as to need no construction, or to refer to committee reports where there can be no doubt of the meaning of the words used.

Helvering v. City Bank etc. Co., 296 U.S. 85, 80 L. Ed. 62, 66.

If, therefore, as the result of the position taken by the Commissioner he seeks to raise a doubt as to the meaning of the plain language, and thereupon reference is made to committee reports which confirm the significance of the plain language of the statute, whatever doubt may have arisen by virtue of the Commissioner's position becomes completely dissipated. The Congressional intent must be controlling in the construction of federal statutes, and it is only in the absence of an express or an implied intent that judicial construction may be resorted to.

McKeown v. So. Cal. etc. Forwarder (Cal.), 52 F. Supp. 331; affirmed 148 F. (2d) 840; cert. denied 66 S. Ct. 46; rehearing denied 66 S. Ct. 138.

See also:

Forrestal v. Commissioner (2d Cir.), 120 F. (2d) 223, 225;

Osaka etc. Line v. U. S., 300 U.S. 98.

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5. **THE AMOUNT OF THE BOND PREMIUM AMORTIZED BY EACH OF THE RESPONDENTS RESPECTIVELY SHOWS SUBSTANTIAL IF NOT EXACT COMPLIANCE WITH THE TERMS OF SECTION 125 OF THE CODE, AND IS THEREFORE FULLY DEDUCTIBLE UNDER SECTION 23 (v) THEREOF.**

All of the material facts in these proceedings were covered by a "Stipulation of Facts" filed with the Tax Court. (R. 20.)

This Stipulation of Facts makes manifest that the respondents have unquestionably complied with all statutory requirements, which compliance may be epitomized as follows:

(1) Subsection (a) (1) of Section 125 requires that bond interest be fully taxable.

Interest on the bonds of American Telephone and Telegraph Company was fully taxable, and the requirement of this subsection was therefore fulfilled.

(2) Subsection (b) (1) requires that in determining the bond premium the holder of "any bond" must use the basis "(for determining loss on sale or exchange)" of such bond and the amount payable at the maturity or earlier call date.

Fulfilling this requirement, the respondent, Joe Shoong, used the difference between the purchase price of $601,-

879.94 (his basis for determining loss) and the earliest call date price of $520,000.00 as the bond premium, thus leaving the balance of $81,879.94 for amortization.

Fulfilling this requirement, the respondent, Rose Shoong, used the difference between the purchase price of $605,607.29 (her basis for determining loss) and the earliest call date price of $520,000.00 as the bond premium, thus leaving the balance of $85,607.29 for amortization.

(3) Subsection (b) (2) defines "amortizable bond premium" as the "amount of the bond premium attributable to such year," meaning the taxable year.

Each of the respondents purchased all of his or her bonds in 1944, and the earliest call date was in 1944. It follows, therefore, that the entire premium was amortizable in conformity with the foregoing provision in the taxable year 1944.

(4) Subsection (b) (3) provides that one method of computing amortizable bond premium in addition to the method which may be employed by the holder of the bond, was such method which may be prescribed by the Commissioner.

Each of the respondents followed precisely the method prescribed by the Commissioner in Regulations 111, Section 29.125-5.

(5) Subsection (c) (2) directs that if the taxpayer makes an election with respect to any bond,

> "* * * it shall also apply to all such bonds held by the taxpayer at the beginning of the first taxable year to which the election applies."

The respondents purchased in 1944 the bonds in question and sought to amortize the bond premium on "all such bonds."

(6) Subsection (d) was designed to deny to security dealers and traders the opportunity of computing bond premium amortization under Section 125 on bonds held as "stock in trade" primarily for sale to customers in the ordinary course of trade or business.

It was stipulated as to each of the respondents under Paragraph 17 of the Stipulation of Facts (R. 28) in effect that neither of the respondents was a security dealer or trader.

The Commissioner claims that the respondents entered into the transactions here under consideration for tax saving purposes, but he does not assert that the transactions are for that reason illegal, or that by virtue thereof the taxpayers should be denied the right of amortizing the bond premium which they paid. In fact, the Commissioner confesses that the question here involved "is essentially one of statutory construction." (Pet. Br. 9.)

Under these circumstances, it has been held time and again that the legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.

Sampson Tire etc. Corp. v. Rogan (9th Cir.), 136 F. (2d) 345, 347;

Commissioner v. Eldridge (9th Cir.), 79 F. (2d) 629, 631;

Gregory v. Helvering, 293 U.S. 465, 469;
U. S. v. Isham, 17 Wall, 496, 506;
Superior Oil Co. v. Mississippi, 280 U.S. 390, 395.

All other facts to which the Commission makes reference are immaterial to the issues of this case, and a review of the foregoing elements in the compliance with the statute and the Regulations will serve to demonstrate that the bond premium as defined by statute and as determined in accordance with statute and Regulations was fully deductible under Section 23 (v) of the Code, and under the law applicable to this case. Involving, as the Commissioner concedes, purely a question of statutory construction (Pet. Br. 9), it becomes quite immaterial whether the bond premium is a "true bond premium" or not, with the Commissioner setting himself up as the one to determine what is true and what is not true.

As indicated, Congress undertook to determine by statute what was to be regarded as an "amortizable bond premium", and so long as Congress spoke clearly, it is not the function of the Commissioner to enlarge upon Congressional language, by a standard which is personal to himself and not even suggested in his Regulations.

CONCLUSION.

It is respectfully submitted that the Tax Court interpreted the statute and the Regulations correctly and that its decision should be affirmed.

Dated, San Francisco, California,
March 28, 1949.

Respectfully submitted,
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(Appendices A and B Follow.)

Appendices A and B.

Appendix A

EXCERPT FROM DECISION BY TAX COURT.

The Memorandum Findings of Fact and Opinion of the Tax Court sets forth or refers to all of the facts, statutes and regulations above set forth. (R. 31.) After such recitation and reference, the Tax Court sustained the contentions of the respondents by stating in part (R. 36): (In order to avoid possible confusion, the following excerpt should be read by substituting the word "respondents" wherever the word "petitioner" appears, and likewise substituting the word "petitioner" wherever the word "respondent" appears.)

> "(Respondents on appeal) Petitioner, in reliance upon information that they would be entitled to claim, in the year 1944, a deduction for amortization of the amount by which the cost exceeded the call price, purchased the bonds with the intention of making such a claim for a deduction for amortization and of selling the bonds after holding them for more than six months so that the gain, if any, upon the sale would be subject to tax as long-term capital gain.
>
> "The principal issue presented for our decision in these cases has recently been decided by this Court in the case of Christian W. [43] Korell, 10 T.C. * * * (Promulgated June 2, 1948). On the authority of this case we decide in favor of the (respondents on appeal) petitioners.
>
> "On brief (petitioner on appeal) respondent contends for the first time that the commissions paid by the (respondents on appeal) petitioners 'are a part of the cost of the securities and are not deductible in

any event as ordinary and necessary business expenses.' (Petitioner on appeal) Respondent does not elaborate this contention except by citing three cases including Helvering v. Winmill, 305 U.S. 79 and Spreckles v. Helvering, 315 U.S. 626. (Respondents on appeal) Petitioner correctly points out in reply that there is no question here presented as to whether these commissions should be capitalized or treated as expenses, but, rather, the question is whether, in the amortization of premiums, the commissions paid are to be treated as part of the purchase price. That such a treatment is proper, is recognized by (petitioner's) respondent's Regulation 111, section 29.125-6.''

Appendix B

EXCERPTS FROM THE DECISION BY TAX COURT IN RE KORELL, 10 T. C. 1001.

The facts in the *Korell* case are substantially the same as those involved in these cases. Except for variations in the quantities of the bonds purchased, the taxpayers in each case purchased the same kind or issue of bonds of the same company, all subject to the same rights, privileges and restrictions. Without introducing the text of the footnotes included in the opinion (the footnotes include substantially the same material set forth in Subdivision D of this brief) the Tax Court declared:

> "OPPER, Judge: When the coupon rate of interest carried by a bond issue exceeds the going rate for obligations of comparable desirability, the market will tend to place a premium on the bonds. If bonds are purchased for investment under such circumstances, the premium paid must be recovered tax-free out of the earnings of the bond very much as depreciation must be recovered out of the income of depreciable property if the true distinction between income and recovery of capital is to be preserved. Cf. *United States v. Ludey,* 274 U.S. 295 [1 USTC, § 234]. With this objective in mind, Congress in 1942 added provisions to the Internal Revenue Code permitting the amortization of bond premium by deductions from gross income.
>
> "A complication bound to arise was the amortization of premium on bonds callable prior to maturity. Such obligations although not included in the statute are covered in a subdivision of the regulations dealing with 'Callable and Convertible Bonds.'

"The debentures purchased by petitioner in the tax year and which form the subject of this controversy were both callable and convertible. They were currently callable at the option of the obligor at any time on thirty days' notice at 104 percent of face. They were convertible at any time at the option of the holder into common stock of the obligor upon payment of the difference between the face of the bond and 140 percent of par.

"Petitioner purchased the debentures at approximately 121 when the common stock of the obligor was selling at 163. Relying upon his interpretation of the statute and the regulations, petitioner deducted the difference between 104, the call price, and 121, his purchase price or basis, as a premium. The entire deduction was taken in the year before us, on the theory that the bond could have been called in that same year, and that in that event the entire premium would have been lost.

"Respondent does not dispute such treatment in the case of a bond callable within the current year, but rejects petitioner's claim here because of the convertible feature of the debentures. His position was set forth in a ruling issued in 1945, dealing with the same issue of debentures as that now in controversy.

"Respondent's reasoning to justify rejection of the claimed deduction is not without force. He says in effect that what Congress was dealing with when it enacted section 125 was, as we have seen, the investment premium paid in excess of the call or maturity price of an obligation which was required to be paid in order to purchase interest income. Respondent's regulations, to be sure, do not provide that no bond

'convertible into stock' is within the definition of an amortizable obligation, but that 'the fact that a bond is * * * convertible into stock does not, in itself, prevent the application of section 125.' This, however, advances us only to the point that the mere aspect of convertibility may not necessarily affect the possibility of the payment of an investment premium. Such would be the situation where the relationship between the conversion figure and the market price of the obligor's stock, eliminated value from the conversion privilege. See Badger, 'Valuation of Industrial Securities,' 42. But in the present case, both the call price and the conversion figures indicate that the premium was paid, not for the investment feature of the bond, but for the rights of conversion.

"The final reference in the regulation to a convertible obligation is that contained in the last sentence of the subdivision previously quoted, reading as follows:

> "'* * * A convertible bond is within the scope of section 125 if the option to convert [on a date certain specified in the bond] rests with the holder thereof.'

If this statement could be taken as fairly interpretative, and whatever its meaning may be, it seems clear that it could under no circumstances apply to these facts, and hence could be disregarded here. The debentures held by petitioner were convertible on any date from the minute he acquired them to their possible future call for redemption and consequently not on 'a date certain.' The result of this sentence would then be neutral and leave open for consideration the question whether the section covered such convertible bonds as those held by petitioner.

"The difficulty with respondent's entire position, however, is that it ignores the interpretation which Congress itself placed upon the legislation. (Emphasis ours.) In both the Ways and Means Committee and Finance Committee reports, there appears in identical language the following:

> " 'The fact that a bond is callable or convertible into stock does not of itself prevent the application of this section. In the case of a callable bond, the earliest call date will, for the purposes of this section, be considered as the maturity date. Hence, the total premium is required to be spread over the period from the date as of which the basis of the bond is established down to the earliest call date, rather than down to the maturity date. In the case of a convertible bond, *if the option to convert the bond into stock rests with the owner of the bond, the bond is within the purview of this section.*' [Italics added.] (Court's italics.)

"The final statement is unequivocal and precisely includes the bonds in controversy. Petitioner's application of the provision to his situation and his computation of the deduction are thus squarely justified by the expression of congressional intent. The portion of the sentence of the regulation quoted above which is enclosed in brackets appears to be a gratuitous addition by respondent not founded upon the statutory language and directly in conflict with its legislative history. We are accordingly unable to ascribe to it the validity which would result in authorizing respondent's position in this proceeding. We see no choice but to disapprove the deficiency."